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SANTO DOMINGO FOR FCS AND FAS

TREASURY FOR SARA GRAY

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SUBJECT: JAMAICA PURSUES "DEVELOPMENT WITH EQUITY"

REF: A) KINGSTON 341

SUMMARY  
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11. (SBU) Jamaica's newly appointed Minister of Finance and Public Service Audley Shaw delivered his maiden budget presentation on April 10. The key speech, entitled "Development with Equity, with the People at the Center of Our Concern," was the first government budget address by a Jamaica Labor Party (JLP) member in 20 years. The 2008/09 budget is forecast at USD 6.9 million, with a focus on: eliminating the fiscal deficit; increasing growth; and reducing the debt-to-GDP ratio. Debt-servicing costs of USD 3.7 billion, again account for the largest share. In addition to current revenue, expenditure will be financed by new tax measures and loan receipts. The JLP-led administration is making a deliberate attempt to widen the tax net, which eventually could reduce its appetite for debt, reduce interest rates, and increase investment and growth. However, given the unfavorable international environment, the Government of Jamaica (GOJ) may be hard pressed to meet its short term targets. End Summary.

Development with Equity  
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12. (SBU) Minister of Finance and Public Service, Audley Shaw, delivered his inaugural budget speech on April 10. This was also the first Parliamentary presentation by a JLP government since 1987, when Prime Minister and Minister of Finance and Planning Edward Seaga had announced that the country would achieve its first surplus in 22 years. Despite the ravages of Hurricane Gilbert, the economy still had registered growth of 2.2 percent a year later, a result Shaw attributed to the foundation laid after the turbulent 1970s. In noting the similarities between the current and post 1970s periods, Shaw suggested that the country is obliged to seek answers from an assessment of past policy errors, which should never be repeated if the country is to progress. He said this progress must be inclusive, with everyone feeling that there is an opportunity for a better life. In this regard, he said the JLP's first budget must lay the framework for "Development with Equity, with the People at the Centre of Our Concern".

JLP'S Framework for Economic Development  
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13. (SBU) In outlining the new government's framework for growth and

development, Shaw alluded to the expectation of the populace for improvements in their living standards based on improved governance and new economic initiatives. Against this background, Shaw outlined his five pillars to rebuild the economy. These include the need to: (1) apply a strong disciplined approach to fiscal and debt management; (2) reform the tax system; (3) reduce bureaucracy, corruption and waste; (4) increase local and foreign investment; and, pursue energy conservation and the development of alternative energy. As part of the fiscal and debt management program, the GOJ has initiated dialogue with multilateral institutions for better terms on loans for heavily-indebted middle income countries (reftel). In the interim, the government has signed policy-based loan agreements for almost USD 120 million, while negotiating another USD 219 million, all priced at interest rates ranging from 4.2 to 6.5 percent.

#### Ambitious Medium Term Framework

¶4. (SBU) With the JLP's promise to deliver robust growth and employment in mind, the 2008/09 macroeconomic program aims to create conditions that support medium term economic expansion. In this regard, the administration is placing emphasis on agriculture and manufacturing, while pursuing fiscal and monetary consolidation to moderate inflation, build up reserves, and bolster investor confidence (Note: Septel will outline the vision for agriculture to address the looming food crisis. End note). Shaw's budget was formulated within a four-year program aimed at eliminating the fiscal deficit and reducing the debt-to-GDP ratio to 100 percent. The medium-term program also is targeting an acceleration in economic growth to three percent, a moderation in prices to ten percent, and a decline in the current account deficit to 15 percent of GDP.

#### The Raw Numbers

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¶5. (SBU) The expenditure budget for 2008/09 amounts to USD 6.9 billion, or 20 percent more than the revised budget for 2007/08. But with inflation running at nearly 20 percent, the new budget is flat in real terms. Of the total expenditure, USD 4.3 billion or 62 percent is set for recurrent or day-to-day spending (this includes interest payments), while the other 38 percent (USD 2.6 billion) is slated for capital spending (includes principal repayment). Debt servicing (interest and principal payments) of about USD 3.7 billion (up 19.5 percent) will again absorb the lion's share of the budget. At this level, 54 cents out of every dollar of expenditure will be spent on repaying the debt in 2008/09. The increased debt servicing costs are a direct result of the absorption of debt accrued by loss making public sector entities such as the airline Air Jamaica, the National Road Construction Company, and the Sugar Company of Jamaica. When wages and salaries of nearly USD 1.5 billion are factored in, this leaves only USD 1.7 billion for social and capital infrastructure. That said, the new government has made a deliberate effort to increase capital spending, which has almost doubled to USD 630 million or 4.7 percent of GDP.

	2007/08	2008/09	2009/10	2010/11
Inflation (percent)	19.2	10.0	8.0	7.0
Real GDP Growth (percent)	0.9	3.0	3.5	3.5
NIR (USD Billion)	1.9	1.9	2.1	2.2
Fiscal Bal/GDP (percent)	-4.7	-4.5	-2.5	0.0

Source: Ministry of Finance and Planning

In keeping with commitments to improve social services and food security, almost 56 percent (USD 1.8 billion) of the non-debt budget has also been allocated to national security, education, health, and agriculture.

#### Financing the Budget

¶6. (SBU) In light of the progressively worsening international economic climate, Shaw pointed out that the financing of the 2008/09

budget has been one of the most challenging in recent years. He said to aggravate the problem, the external capital market and international financial institutions are paying increased attention to Jamaica's medium term fiscal profile, after years of missed targets. With tax compliance running at around only 38 percent, and with outstanding taxes amounting to almost USD 1 billion (excludes interest and penalties), the GOJ plans to adopt an aggressive strategy to increase revenue collections through among other things audit and assessment, collections, and taxpayer education (reftel). At the centre of this strategy is a tax amnesty package, which will run from June to October 2008. More specifically, the 2008/09 budget will be financed by a combination of revenues, grants and loan receipts. Revenues are projected to increase by 18.3 percent to USD 4.2 billion and grants by 21.9 percent to USD 77 million, while loan receipts are expected to provide another USD 2.6 billion. This amount includes USD 126 million from multilateral and bilateral sources for capital projects.

#### Tax Reform and Limited Tax Package -----

17. (SBU) In order to fill the gap and achieve the fiscal deficit target of 4.5 percent of GDP, the government proposed a limited tax package of USD 75.8 million, while giving back USD 33 million in concessions for a net amount of USD 42 million. A significant amount of the increase is expected to come from higher cigarette taxes, also a strategy to reduce the incidence of smoking. Additional funds will be generated from higher motor vehicle taxes. The goal is also to reduce fuel consumption by charging higher taxes on less fuel efficient vehicles.

18. (SBU) To stimulate investment and growth, the GOJ has removed the tax on private dividends and reduced the transfer and stamp duty on real estate transactions. Shaw announced that a team led by Minister Without Portfolio Don Wehby are engaged in an extensive review of proposed tax reform measures. Shaw reiterated his government's commitment to the process, which was last overhauled 21 years ago. To kick start the process, he proposes a consolidation of the more than five different statutory deductions into one social security payment this fiscal year. He also outlined plans for administrative reforms to include the tax amnesty.

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#### Comments -----

19. (SBU) After almost 20 years out of power, the JLP has embarked on an ambitious program geared at fiscal consolidation, debt reduction, and accelerated growth. This is particularly important as the JLP is cognizant of its promise to deliver jobs. Shaw is hoping that his Party's pursuit of good governance will lead to reduced corruption, waste, bureaucracy, and red tape. He also is banking on the removal of at least two loss making entities from the budget this fiscal year: Air Jamaica and the sugar estates. But promises aside, after years of missed targets, the achievement of the fiscal target will be critical to regain the country's credibility among external creditors. In this regard, the government may have erred in understating its inflation target, as prices are already running at 5.2 percent for the first three months of 2008-- more than half the 10 percent calendar year target. Although the tax measures targeting energy conservation are commendable, they will only add to the price instability (policy induced); add the cost push effect of rising commodity prices, and the problem magnifies. Runaway prices also could bring other challenges as they could impact interest cost and stymie private sector borrowing, thus derailing the growth agenda. Worse yet, any up-tick in interest rates could increase the debt stock, which now stands at USD 14 billion. The GOJ will have to wish for better than anticipated returns from its tax amnesty, as well as increased borrowing from multilaterals, to improve the fiscal dynamics. (Note: Septel will provide external comments on the budget. End note). End comment.

JOHNSON